



First Friday Fraud Facts+

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The Idaho State Controller's Office distributes this newsletter as a public service and as a cost-effective method of increasing awareness about ways to detect and prevent fraud, waste, and abuse in government.

Payroll Fraud Schemes

Payroll fraud is the number one source of employee theft and accounting fraud according to the Association of Certified Fraud Examiners. Payroll fraud occurs when an employee makes false claims for compensation causing an entity to issue a payment. In 2014, the median payroll fraud lasted about 24 months and resulted in a median loss of \$50,000.¹ The most prevalent methods of payroll fraud are:

- Fictitious "ghost" employees
- Falsified timecards
- Falsified salary information
- Borrowing tax withholdings



Fictitious Employees

A fictitious or "ghost" employee refers to someone on the payroll who does not actually work for the victim entity. This happens when a fraudster falsifies payroll records to generate a payment to a fictitious employee. The perpetrator then collects the falsified payment, essentially increasing his/her income.



Falsified Timecards

Falsifying timecards is one of the easiest payroll schemes for a fraudster to execute. The ease of execution makes timecard falsification the most popular payroll scheme. The scheme takes place when an employee claims hours on his or her timecard that were not actually worked.

Falsified Salary

The falsification of salary is accomplished by increasing one's rate of pay. To execute this type of scheme, a fraudster must have access to changing their rate of pay or must collude with someone that can change it for them.

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Borrowing Tax Withholdings

This payroll fraud scheme is perpetrated when an employee “borrows” the company’s tax withholdings and deposits them in his or her personal account with the intent of earning interest on the usually very large principal balance. The employee returns the funds when the taxes are due by paying the taxing authority, but keeps the interest earned for themselves.²

Red Flags of Payroll Fraud

According to the Association of Certified Fraud Examiners, red flags of payroll fraud schemes include the following:

- Living beyond means
- Financial difficulties
- Unwillingness to share duties
- Divorce/family problems
- Irritability or defensiveness
- Addiction problems
- Complaints about inadequate pay
- Refusal to take vacations
- Excessive pressure for success¹

What YOU Can Do

Segregation of Duties

The idea behind segregation of duties is to separate the activities of record keeping, calculation, and authorization.³

The following duties must be segregated to deter payroll fraud:

- Payroll preparation
- Payroll disbursements (into payroll and withholding tax accounts)
- Payroll distribution
- Payroll bank reconciliations
- Human resource departmental functions

Having strong internal controls is a good start to preventing payroll fraud. However, combining internal controls with adequate monitoring of both employees and expenses is the key to preventing and detecting payroll fraud schemes.

Below are some suggestions for preventing and detecting payroll fraud:

- Be aware of employees that are living above their means or that are irritable and defensive.



- Require employees switch responsibilities periodically, especially employees that process payroll. This will prevent a fraudster from covering up a fraud.
- Review employee bank account numbers and addresses to find if multiple payments are going to the same bank account or address.
- Review expense reports to verify their accuracy. Question anything that does not look correct.
- Compare budgets with actual expenses to verify expenditures are what they should be. Ask questions if they are not.
- Review payroll distribution lists for reasonableness.
- Monitor overtime payments. Are they reasonable when considering the work performed? Are they supported and approved?
- Monitor and review leave hours taken. Have any of your employees taken time off? Have they properly reported the time off on their time-sheets?



Ghost Employee Case at Grady Memorial

Grady Memorial is the largest hospital in Georgia and is the primary public hospital for the city of Atlanta. It has about 5,000 employees and is located next to the campus of Georgia State University. For over 100 years Grady has provided low-cost medical care to thousands of Atlanta-area residents, many of whom are uninsured.

In 2015, the former Payroll Director of Grady Memorial, Donald Thomas, was sentenced to seven years, three months in prison for stealing nearly half a million dollars. The former director worked for Grady from December 1994 to June 2011.

Thomas, as the payroll director, had nearly exclusive control over Grady's payroll systems. For over three years, he falsified vacation and severance pay amounts for former Grady employees. Thomas reversed these fraudulent charges in the payroll system and had the funds deposited into a business account, rather than his own, to cover up the fraud. Thomas was laid off in a workforce reduction in 2011 before the fraud was discovered.

Prior to leaving in 2011, Thomas became careless about covering up his tracks, and as a result, some of the falsified payments he embezzled were discovered. Ex-employees discovered the fraud while examining their W2 forms. In early 2012, one of the ex-employees questioned the overstated W2 amount and complained about it to Grady. Further investigation led to the discovery of 136 fraudulent transactions spanning over three years. Over the course of the scheme, Thomas stole over \$480,000.⁴



Citations

- ¹ Association of Certified Fraud Examiners. "Report to the Nations on Occupational Fraud and Abuse." Retrieved on February 12, 2016 from: <http://www.acfe.com/rtn/docs/2014-report-to-nations.pdf>
- ² McGovern & Greene LLP. "Employee Frauds – Payroll." Retrieved on January 29, 2016 from: http://www.mcgoverngreene.com/archives/archive_articles/Craig_Greene_Archives/Focus-Employee_Frauds-Payroll.html
- ³ Association of Certified Fraud Examiners. "2007 Fraud Examiners Manual." Section 1.567.
- ⁴ The Federal Bureau of Investigation. "Former Grady Hospital Payroll Director Sentenced for Embezzling from Grady." Retrieved on February 12, 2016 from: <https://www.fbi.gov/atlanta/press-releases/2015/former-grady-hospital-payroll-director-sentenced-for-embezzling-from-grady>

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